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Office of the Legislative Auditor

State of Montana

Report to the Legislature

December 1994

Financial-Compliance Audit

For the Two Fiscal Years Ended June 30, 1994

Department of Military Affairs

This report contains recommendations for improvement in the department's operations. Items addressed in the report include:

- **Accuracy of accounting records.**
- **Accounting for land, buildings and equipment.**
- **Monitoring of entities receiving subgrants from the department.**

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FINANCIAL-COMPLIANCE AUDITS

Financial-compliance audits are conducted by the Office of the Legislative Auditor to determine if an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations which could have a significant financial impact. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States General Accounting Office. Financial-compliance audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

The Single Audit Act of 1984 and OMB Circular A-128 require the auditor to issue certain financial, internal control, and compliance reports regarding the state's federal financial assistance programs, including all findings of noncompliance and questioned costs. This individual agency audit report is not intended to comply with the Single Audit Act of 1984 or OMB Circular A-128 and is therefore not intended for distribution to federal grantor agencies. The Office of the Legislative Auditor issues a statewide biennial Single Audit Report which complies with the reporting requirements listed above. The Single Audit Report for the two fiscal years ended June 30, 1993 has been issued. Copies of the Single Audit Report can be obtained by contacting:

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Office of the Legislative Auditor

Financial-Compliance Audit
For the Two Fiscal Years Ended June 30, 1994

Department of Military Affairs

Members of the audit staff involved in this audit were: Jody Brandt, Frieda Houser, and Emlyn Neuman-Javornik.

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December 1994

The Legislative Audit Committee
of the Montana State Legislature:

This is our financial-compliance audit report on the Department of Military Affairs for the two fiscal years ended June 30, 1994. Included in this report are recommendations concerning: proper recording of fixed assets, accuracy of accounting records, subrecipient monitoring and compliance with state law and policy.

We thank the Adjutant General and his staff for their assistance and cooperation.

Respectfully submitted,

Scott A. Seacat
Legislative Auditor

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Appointed and Administrative Officials

Department of Military Affairs	John E. Prendergast	Adjutant General
	Doug Booker	Administrator Centralized Services Division
	Jim Greene	Administrator Disaster and Emergency Services Division
	James F. Jacobsen	Administrator Veterans Affairs Division

		Term Expires
Board of Veterans Affairs	Thaddeous Mayer, Chairman	May 1996
	George Hageman, Vice Chairman	May 1997
	Ruben McKinney, Secretary	May 1995
	Bernadette Opp, Member	May 1998
	Johnny Buck, Member	May 1999

Summary of Recommendations

The listing below serves as a means of summarizing the recommendations contained in the report, the department's response thereto, and a reference to the supporting comments.

Recommendation #1 — We recommend the department revise procedures to ensure revenue and expenditures are properly recorded in accordance with state law and policy. 8

Agency Response: Concur. See page B-3.

Recommendation #2 — We recommend the department ensure fixed assets are recorded in accordance with state policy. 10

Agency Response: Concur. See page B-3.

Recommendation #3 — We recommend the department:

A. Ensure subrecipients have audits completed which comply with federal requirements. 11

Agency Response: Concur. See page B-3.

B. Establish a system to monitor subrecipients' compliance with applicable grant requirements. 11

Agency Response: Concur. See page B-3.

Recommendation #4 — We recommend the department establish policies and procedures to ensure travel reimbursements comply with state laws and accounting policies. 13

Agency Response: Concur. See page B-4.

Recommendation #5 — We recommend the department make timely payments in accordance with state law. 14

Agency Response: Concur. See page B-4.

Recommendation #6 — We recommend the department establish internal controls over collections in accordance with state law and accounting policies. 16

Agency Response: Concur. See page B-4.

Introduction

We performed the financial-compliance audit of the Department of Military Affairs for the two fiscal years ended June 30, 1994. The objectives of the audit were to:

1. Determine if the department complied with applicable state and federal laws and regulations.
2. Recommend improvements in the management and internal controls of the department.
3. Determine if the department's financial schedules fairly present the results of operations for the audit period.
4. Determine the implementation status of prior audit recommendations.

This report contains six recommendations to the department. These recommendations address areas where the department can improve internal controls, accounting procedures, and compliance with laws and regulations. In accordance with section 5-13-307, MCA, we analyzed and disclosed the cost, if significant, of implementing the recommendations in this report.

Areas of concern deemed not to have a significant effect on the successful operations of the department are not specifically included in the report, but have been discussed with management.

Background

The department was created under the Executive Reorganization Act of 1971. The department consists of the Montana National Guard, Centralized Services, Disaster and Emergency Services, and Veterans Affairs Divisions.

The Montana National Guard Division is authorized approximately 54 full-time equivalent (FTE) positions. The division administers the Army National Guard and the Air National Guard programs, and provides trained and equipped military personnel in the event of a state or national emergency.

Centralized Services Division (CSD) is authorized approximately seven FTE. CSD is the primary administrative support

organization for the department, including financial management, budgeting, personnel, and other administrative activities. CSD is responsible for the expenditures of the operations support program, as reported on the financial schedules on pages A-7 and A-8.

Disaster and Emergency Services Division (DES) is responsible for the preparation, implementation, and maintenance of plans and programs for the state's emergency operations in the event of a disaster. The Disaster Coordination and Response Program ensures proper distribution of all federal disaster relief funds to public entities as authorized by presidential disaster declarations. The Emergency Management Development Program supplements the Disaster Coordination and Response Program in preparing and updating local and state emergency preparedness plans. This division is authorized 20 FTE and administers both the expenditure programs identified above and the Local Civil Defense Reimbursement and the Disaster Relief Fund programs. In fiscal year 1993-94, the Emergency Management Development and Local Civil Defense Reimbursement programs were combined into the Disaster Coordination and Response Program.

The Veterans Affairs Division (VA) is authorized approximately 19 FTE and is responsible for assisting Montana's veterans and dependents in obtaining veterans' benefits. The division provides information on benefits, guidance on completing veterans' administration forms, and referral to other agencies. The division is attached to the department for administrative purposes. The division administrator is hired by and reports to the Board of Veterans Affairs. The board is appointed by the governor with the consent of the senate. The division is responsible for the VA program expenditures.

In addition to the Montana Department of Military Affairs activity, other Montana National Guard activities are directly funded by the federal government. According to department officials, federal funding for the Air and Army National Guard during federal fiscal year 1992-93 was approximately $29.5 million and $44.8 million, respectively. These funds were used for National Guard personnel salaries and training and to purchase equipment.

Prior Audit Recommendations

Prior Audit Recommendations

Our office performed the department's financial compliance audit for the two fiscal years ended June 30, 1992. The report contained five recommendations still applicable to the department. We determined the department implemented three and partially implemented two of the recommendations.

The recommendations which were partially implemented relate to property, plant and equipment and timeliness of payments as discussed on pages 8 and 14, respectively.

Findings and Recommendations

Accuracy of Accounting Records

Financial information of the department is used by department officials, budget analysts, and the legislature to manage and establish funding levels for the department. State law requires transactions entered on the state's accounting system be recorded in accordance with Generally Accepted Accounting Principles (GAAP). The Department of Administration, Accounting Bureau, has adopted state accounting policies which comply with GAAP. Accounting for financial activity in accordance with these requirements improves the quality, consistency and comparability of the resulting financial information among state agencies. It also ensures that revenue and expenditures are properly and consistently measured within each fiscal year. We noted the following instances where the department did not use established expenditure codes, accrue expenditures and revenue, or record revenue in accordance with state law and accounting policies.

Recording of Expenditures

Department of Administration, Accounting Bureau, established expenditure codes for agencies to use so information recorded on the state's accounting system would clearly identify the nature of amounts disbursed and be consistently recorded by all agencies. We noted numerous instances where the department did not use established expenditure codes in accordance with state policy.

-- The department's Disaster and Emergency Services Division (DES) records all expenditures from federal assistance funds under "grants from federal sources." State policy defines "grants from federal sources" as moneys derived from federal sources and given to other entities . . . to be used or distributed by the recipient entities as specified by the grant agreement. We noted $157,524 and $103,029 of expenditures in fiscal years 1992-93 and 1993-94, respectively, which were not granted to other entities that should have been recorded under "operating" or "equipment" expenditure codes.

   DES personnel stated the expenditures are recorded in this manner for tracking purposes. The state's accounting system provides alternative methods for tracking expenditures that allows financial information to be recorded in accordance with state policy.

-- In fiscal year 1993-94, the department recorded a $5,000 construction project for a veteran's cemetery directory wall under "repair and maintenance." This transaction should have been recorded as "capital outlay." State policy defines capital outlay as including "all expenses relating to the purchase of . . . buildings."

-- In fiscal year 1993-94, the department recorded a $6,000 tractor purchase as a "debt service lease" rather than "capital leases-equipment." State policy defines debt service as including "all disbursements related to the retirement of long-term debts." State policy states capital leases-equipment expenditure codes are used "to separate capital leases from normal equipment purchases for accounting purposes."

-- The Army National Guard Program operating expenditures in fiscal years 1992-93 and 1993-94 were $1,616,138 and $1,697,418, respectively. CSD recorded operating expenditures, not previously coded by the Facilities Management Office (FMO) and excluding janitorial supplies, to "repair and maintenance." Department personnel stated additional information and time would be required to code transactions in further detail. We were unable to determine the dollar effect of this issue, but anticipate it is approximately 25 percent or $100,000 and $90,000 in fiscal years 1992-93 and 1993-94, respectively, of the expenditures recorded under the Army National Guard Program "repair and maintenance" expenditure code.

-- In fiscal year 1993-94, the department moved $25,000 of janitorial service contract expenditures for the Air National Guard Program from the "other services" category to "repair and maintenance." These costs have historically been recorded under "other services." Department personnel stated these were proper expenditures under either category. While this is true, changing the recording of program expenditures reduces comparability of financial information between fiscal years. In addition, fiscal year 1993-94 is a base budget year and the expenditures were moved from a zero base line item to an actual expenditure line item. The effect is to cause this amount to be included in the department's budget base even though the janitorial services contract was discontinued in fiscal year 1994-95.

-- In fiscal year 1993-94, the department moved "other services" expenditures for firefighters insurance and legal services totalling $29,000 from the Air National Guard Program to the Operations Support Program. Department personnel stated appropriation authority remained in the

Operations Support Program and the expenditures were legitimate from either program. Expenditures should be recorded under the program which receives the benefit. The department could have transferred appropriation authority from the Operations Support Program to the Air National Guard Program to facilitate proper recording of the expenditures.

We noted the following instances where a valid obligation did not exist yet the department established expenditure accruals.

-- In fiscal year 1991-92, the department accrued $28,402 of expenditures related to contracts for painting two armories. The contracts were not signed until fiscal year 1992-93, therefore, a valid obligation at fiscal year-end 1991-92 did not exist. As a result, expenditures are overstated in fiscal year 1991-92 and understated in fiscal year 1992-93 in the General Fund. Department personnel stated they accrued the expenditures based on the contract acceptance date of June 30, 1992. A valid obligation exists when the parties involved sign the contract. The contract was not signed until July 1992.

-- DES establishes accruals at fiscal year-end for expenditures incurred by the counties, but not yet reimbursed by the state. We noted DES accrues the full amount expended by the counties even though historically the federal funding will cover only 80-95 percent of actual expenditures. In fiscal year 1992-93, DES wrote off 39 percent of expenditure accruals made in fiscal year 1991-92. The percentage decreased to 6 percent in fiscal year 1993-94 for fiscal year 1992-93 accruals. As of September 1994, the accrual write-off for fiscal year 1993-94 had not been determined. The accruals result in an overstatement of expenditures in each fiscal year. The department should establish county expenditure accruals based on estimated federal reimbursement, not total county expenditures.

Recording of Revenue

State policy requires revenue be recognized in the period in which it is both measurable and available. We noted the following instances where the department did not record revenue in accordance with state policy.

-- The department pays a vendor on a monthly basis for M1 tank security. The department is later reimbursed by the federal government. The department recorded current year

expenditures for February, March, and April 1993 services, however, when the revenue was received from the federal government it was recorded as prior year revenue. As a result, current year revenue is understated and prior year revenue is overstated by $77,694, in fiscal year 1992-93.

In addition, we noted the department did not accrue revenue for May and June 1993 services by fiscal year-end 1992-93. As a result, fiscal year 1992-93 revenue and ending fund balance is understated by $61,646. Department personnel stated the revenue was overlooked when establishing accruals at fiscal year-end.

-- At fiscal year-end 1992-93, department personnel attempted to process a transaction on the state's accounting records in order to properly reflect federal revenue, however, the transaction rejected and was not processed. A correcting transaction was not processed in fiscal year 1993-94, since department personnel were not aware the problem still existed. As a result, revenue and ending fund balance is understated in fiscal year 1992-93 and ending fund balance is understated in fiscal year 1993-94 by approximately $28,000 in the Special Revenue Fund.

-- In fiscal year 1992-93, the department recovered $10,416 of insurance costs from the federal government. The expenditures were originally charged to the General Fund in fiscal year 1991-92. The department recorded fiscal year 1992-93 revenue in the General Fund rather than prior year revenue when the federal revenue was received. As a result, revenue is not matched with applicable expenditures in fiscal year 1991-92 or 1992-93.

Summary

The department has established procedures where various divisions establish accounting codes for a transaction prior to sending the transaction with attached support to CSD. CSD personnel record the transactions on the state's accounting records as instructed by the various divisions. These procedures result in inconsistent recording of information between the divisions and CSD. Many of the issues discussed above resulted from human error or a lack of knowledge of state law and accounting policy. CSD was created in order to coordinate department accounting functions and improve internal controls. Procedures as established result in the accounting function operating in a decentralized manner.

The department is responsible for all of the financial information recorded on its accounting records. The department's accounting personnel should perform the necessary review to ensure information recorded is accurate, complete, and consistent. The department should revise procedures to ensure all expenditure and revenue transactions are properly recorded on the state's accounting records.

The number and type of expenditure coding errors resulted in the issuance of a qualified opinion on the department's expenditures for both fiscal years.

Recommendation #1

We recommend the department revise procedures to ensure revenue and expenditures are properly recorded in accordance with state law and policy.

Property, Plant and Equipment

The state maintains a Property Accountability Management System (PAMS). This system allows agencies to manage and account for the state's investment in land, buildings and equipment. The purpose of PAMS is to establish accountability and facilitate safeguarding of recorded assets. We reported problems in the department's accounting for fixed assets in each of our last six audit reports. During the last audit the department had assigned an individual the responsibility of ensuring fixed assets were recorded properly on PAMS. During the current audit we noted the department corrected most of the issues noted in the previous audit report. However, we still found concerns in this area.

-- We noted construction projects totalling $1,031,131 which were not recorded as buildings or were recorded at the wrong amount. We also noted projects totalling $53,030 which were recorded as construction work-in-progress rather than buildings. State policy requires projects to be recorded as buildings when the project is completed or when the asset is placed in use.

-- We noted projects totalling $380,925 which were recorded as construction work-in-progress which were actually repair and maintenance or improvements to federal buildings. These projects should not have been recorded on PAMS at fiscal year-end 1993-94.

-- We noted $92,753 in land was not recorded on PAMS.

-- We noted $406,712 in construction work-in-progress that was not recorded at fiscal year-end 1993-94. State policy requires, if a project is not completed within a fiscal year, the completed portion should be recorded as construction work-in-progress at fiscal year-end.

-- We noted two coding errors in recording the information on PAMS. Buildings were incorrectly coded to equipment ($178,157) and construction work-in-progress ($753,096). Department personnel stated the building ($753,096) was incorrectly recorded as construction work-in-progress. After further review, department personnel determined the construction work-in-progress actually relates to a federal building and; therefore, should not be recorded on the state's accounting records.

As a result of the above errors, land and buildings are understated on PAMS by $92,753 and $1,262,318, respectively, at fiscal year-end 1993-94. In addition, equipment is overstated by $178,157 and construction work-in-progress is overstated by $727,309 on PAMS at fiscal year-end 1993-94.

According to department personnel, they do not record projects on PAMS until a final completion report is received from Department of Administration's, Architecture & Engineering Division (A&E), since at that point the employee is aware of the stage of completion and the final cost. Department personnel stated they were responsible for many other duties within CSD and are unable to allocate the time required in this area.

The department handles a large volume of repair and maintenance, and construction projects which relate to the Army National Guard. The projects are coordinated between the Facilities Management Office (FMO) and A&E. The information required by CSD to properly record property at fiscal year-end on PAMS is available at FMO. Due to the significant dollars involved and the continuing problems noted in this area.

we believe the department should require information be provided to CSD to ensure its fixed assets are properly recorded on PAMS.

Recommendation #2

We recommend the department ensure fixed assets are recorded in accordance with state policy.

Subrecipient Monitoring

The department subgrants federal financial assistance moneys it receives from the U.S. Federal Emergency Management Agency. During the audit period, the department awarded over $1 million of federal funds to subrecipients. The department subgrants federal funds to counties and the Fire Services Training School of Montana State University.

The Office of Management and Budget (OMB) Circular A-128, requires a state or local government that receives federal assistance and provides $25,000 or more in a fiscal year to a subrecipient to ensure the subrecipient meets certain requirements. One requirement is to determine whether subrecipients have met applicable federal audit requirements. Another requirement is to determine whether the subrecipient spent federal assistance funds provided in accordance with applicable laws and regulations.

We noted the department has not established a system to ensure the requirements of OMB Circular A-128 are met. This includes obtaining an audit report from the subrecipient, monitoring for compliance with federal regulations, following up on deficiencies noted, and ensuring records are retained for the required length of time.

Department personnel stated they were not aware of the OMB Circular A-128 requirements. Department personnel attended a

training course in August 1994 regarding this circular and its requirements. The department should ensure subrecipients have audits completed which comply with OMB Circular A-128. The department should also establish a system to monitor the subrecipients' compliance with applicable grant requirements.

Title 2, chapter 7, part 5, MCA, is cited as the State Single Audit Act. The Act places the responsibility of auditing all counties, at least every two years, on the Local Government Services Bureau (LGS) of the Department of Commerce. An audit conducted pursuant to this part is in lieu of any compliance audit that a local government is required to conduct under any other federal regulation. As grantor, the department is responsible to ensure subrecipient contracts are properly administered and the required audits are conducted. When establishing its subrecipient monitoring system, the department should contact LGS and ensure no duplication exists between the departments.

Recommendation #3

We recommend the department:

A. Ensure subrecipients have audits completed which comply with federal requirements.

B. Establish a system to monitor subrecipients' compliance with applicable grant requirements.

State Compliance

As part of our audit, we tested compliance with certain state laws and policies related to the department operations. We noted the following instances where the department did not comply with provisions of state laws and policies.

Travel

During fiscal years 1992-93 and 1993-94, the department recorded approximately $218,000 of travel expenses on the state's accounting records. We reviewed travel expense vouchers submitted by department employees during the audit period and noted the following concerns.

-- Section 2-18-503, MCA, establishes personal vehicle mileage reimbursement rates. A lower rate is established for Helena based employees using a personal vehicle when a motor pool vehicle is available. If a motor pool vehicle is unavailable, state law allows departments to reimburse employee's for using personal vehicles at a rate of three cents higher than the lower rate. In order to claim the higher rate, the employee must obtain an authorization form from the state Motor Pool. We noted 36 instances where the department reimbursed Helena based employees at the higher rate for personal vehicle use without motor pool authorization.

-- Additionally, if the employee is authorized to use the higher mileage rate, the law limits reimbursement at that rate to 1,000 miles per month. If miles traveled per month exceed 1,000, reimbursement for the excess mileage is required to be made at the lower rate. We noted seven instances where the department reimbursed employees at the higher mileage rate for mileage exceeding the 1,000 mile limit. Miles reimbursed over 1,000 ranged from 62 to 860.

-- We noted six instances where the department reimbursed employees for lodging which exceeded the allowable rate. The excess amounts ranged from $3 to $31 per night.

-- We noted one claim where a credit card receipt was attached for lodging instead of the lodging receipt.

-- We noted four instances where employees were reimbursed for miscellaneous expenses exceeding $10 without submitting receipts.

-- We noted one instance where meals paid exceeded the amount allowed by law.

-- We noted five instances where employee travel expense vouchers were not approved by the employee's supervisor.

Sections 2-18-501 and 2-18-503, MCA, provide specific meal and lodging reimbursement rates and establish mileage limits and rates which may be claimed. State policy requires original lodging receipts be attached to the travel expense voucher and retained by the agency. Other receipts, such as credit card receipts, are not acceptable. State policy also requires expense items of $10 or more be supported by receipts. In addition, state policy requires the travel expense voucher be reviewed and approved by the employee's immediate supervisor or authorized agency official.

According to department personnel, travel regulations have not been enforced as strictly as they should have been. Additionally, department personnel stated they were not aware of the 1,000 mile per month limitation. The items noted indicate employees and supervisors approving travel expense vouchers should become familiar with state laws and accounting policies regarding travel. In addition, the department should consider increasing the use of state motor pool vehicles. We noted employees based in the Helena area used personal vehicles on a regular basis. The motor pool rate varies between fiscal years. The motor pool rate in fiscal year 1992-93 was 22 cents and in fiscal year 1993-94 was 14 cents per mile compared to the personal vehicle reimbursement rate of 25 cents per mile. We determined using state motor pool vehicles would have saved the department and the state approximately $1,500.

Recommendation #4

We recommend the department establish policies and procedures to ensure travel reimbursements comply with state laws and accounting policies.

Timeliness of Payments

Section 17-8-242, MCA, requires state agencies to pay invoices within 30 days of the receipt of properly completed invoices. In the previous audit we noted a significant number of invoices which were not paid within the 30 day requirement. We noted payment of these invoices ranged from one month to several months after the due date. During the current audit, we noted the department made substantial improvements in paying invoices timely; however, we still noted concerns in this area.

We reviewed two months during the audit period and noted 10 percent of the Facilities Management Office (FMO) invoices were not received by CSD in time for the department to comply with state law. Payment for these bills ranged from two days to two weeks after the due date.

There are two employees, one state and one federal, at FMO who are responsible for approval of invoices. Since the last audit, the department shifted much of the invoice approval requirements to the state employee. This expedited the invoice approval process, and enabled CSD to pay invoices prior to the due date. The instances of untimely payments we noted resulted from the federal employee not submitting invoices to CSD in time to meet the due date. Federal personnel stated they had other duties which kept them from allocating the time required to review invoices in order to meet state due dates. Department officials should move all approval of invoices to the state employee to ensure compliance with state law.

Recommendation #5

We recommend the department make timely payments in accordance with state law.

Cash Collection Procedures

The department's Veterans Affairs Division (VA) receives donations, consisting of cash and checks, to support its cemetery operations. During fiscal years 1992-93 and 1993-94 the department collected approximately $1,700 and $5,400, respectively, in cemetery donations. According to department officials, the donations increased due to a more active campaign for contributions. The increase in revenue received from private sources also increases the importance of establishing good control over money received.

We noted the VA does not restrictively endorse checks upon receipt, maintain a check log documenting amounts received, or deposit funds on a timely basis. Section 17-6-105(6), MCA, requires all moneys be deposited daily with the state treasurer whenever the accumulated amount of coin and currency exceeds $100 or total collections exceed $500. All moneys collected must be deposited at least weekly. State policy requires checks to be restrictively endorsed at the time of initial receipt and a check log be maintained documenting the amount collected, when deposited, and the collection report number.

VA personnel stated a thank you letter for each donation is written prior to depositing the money. According to VA personnel, this is usually completed the day of receipt. The cash and checks are given to CSD which restrictively endorses the checks, prepares a check log, and deposits the money. Requiring CSD to prepare the check log, at a later date, increases the risk checks or cash could be misplaced prior to recording the information in the check log. In addition, the check log prepared by CSD does not contain the collection report number; therefore, it was difficult to determine when the checks were deposited with the state treasurer. However, we reviewed collection reports and noted copies of the checks attached contained dates which exceeded the weekly deposit requirement. Based on this review it appeared deposits were not being made within the time frame required by state law.

Recommendation #6

We recommend the department establish internal controls over collections in accordance with state law and accounting policies.

Independent Auditor's Report & Agency Financial Schedules

Summary of Independent Auditor's Report

Summary of Independent Auditor's Report

The financial schedules are prepared from the Statewide Budgeting and Accounting System without adjustments for errors noted during the audit. The auditor's opinion issued in this report is intended to convey to the reader of the financial schedules the degree of reliance which can be placed on the amounts presented.

We included paragraph four in the Independent Auditor's Report to qualify our opinion on the financial schedules due to the number, dollar amount, and types of expenditure classification errors discussed on pages 4 to 6. The reader should use caution when using the financial information in these schedules.

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JIM PELLEGRINI
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INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying financial schedules of the Department of Military Affairs for each of the two fiscal years ended June 30, 1993 and 1994, as shown on pages A-5 through A-11. The information contained in these financial schedules is the responsibility of the department's management. Our responsibility is to express an opinion on these financial schedules based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosure in the financial schedules. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial schedule presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in note 1, the financial schedules are presented on a comprehensive basis of accounting other than generally accepted accounting principles. The schedules are not intended to be a complete presentation and disclosure of the department's assets, liabilities, and cash flows.

The department did not record the following expenditures under proper expenditure codes or proper programs in fiscal years 1992-93 and 1993-94.

* Grants from federal sources expenditures in the Emergency Local Reimbursement DES Program in fiscal year 1992-93 and the Disaster Coordination Response Program in fiscal year 1993-94 are overstated by $157,524 and $103,029, respectively, and operating and equipment expenditures are understated by the same amounts.

* Repair and maintenance expenditures in the Army National Guard Program are overstated by approximately $100,000 and $90,000 in fiscal years 1992-93 and 1993-94, respectively, and other operating and equipment expenditures are understated by the same amounts.

* Other services expenditures are overstated in the Operations Support Program and understated in the Air National Guard Program by $29,000 in fiscal year 1993-94.

* Repair and maintenance expenditures in the Air National Guard Program are overstated and other services are understated by $25,000 in fiscal year 1993-94.

* Debt service lease expenditures in the Veterans Affairs Program are overstated and equipment is understated by $6,164 in fiscal year 1993-94.

* Capital outlay expenditures in the Veterans Affairs Program are understated and repair and maintenance is overstated by $5,000 in fiscal year 1993-94.

As a result, expenditures as reported on the Schedules of Budgeted Program Expenditures and Transfers Out By Object and Fund - Budget and Actual are misleading.

In our opinion, except for the effects of the matters discussed in paragraph four, the financial schedules referred to above present fairly, in all material respects, the results of operations and changes in fund balances of the Department of Military Affairs for the two fiscal years ended June 30, 1993 and 1994, in conformity with the basis of accounting described in note 1.

Respectfully submitted,

James Gillett, CPA
Deputy Legislative Auditor

September 21, 1994

DEPARTMENT OF MILITARY AFFAIRS
SCHEDULE OF CHANGES IN FUND BALANCES
FOR THE TWO FISCAL YEARS ENDED JUNE 30, 1994

	General Fund	Special Revenue Funds	Capital Projects Funds
FUND BALANCE: June 30, 1992	$ 0	$ 23,649	$ 0
ADDITIONS			
Fiscal Year 1992-93			
Budgeted Revenue		4,429,434	
Nonbudgeted Revenue	39,950		
Support From State of Montana	2,311,001		
Prior Year Revenue Adjustments		148,844	
Prior Year Expenditures	3,115		
Prior Year Expenditure Adjustments		16,372	
Cash Transfers In			25,000
Fiscal Year 1993-94			
Budgeted Revenue		5,366,558	
Nonbudgeted Revenue	11,319	9,998	
Support From State of Montana	2,053,844		
Prior Year Expenditure Adjustments		15,655	
Total Additions	4,419,229	9,986,861	25,000
REDUCTIONS			
Fiscal Year 1992-93			
Budgeted Expenditures	2,338,703	4,164,119	25,000
Prior Year Expenditures		2,572	
Prior Year Expenditure Adjustments	15,363		
Cash Transfers Out		430,219	
Fiscal Year 1993-94			
Budgeted Expenditures & Transfers Out	2,061,822	4,306,077	
Nonbudgeted Expenditures		9,966	
Prior Year Expenditure Adjustments	3,341		
Prior Year Revenue Adjustments		15,331	
Cash Transfers Out		656,443	
Total Reductions	4,419,229	9,584,727	25,000
FUND BALANCE: June 30, 1994	$ 0	$ 425,783	$ 0

This schedule is prepared from the Statewide Budgeting and Accounting System. Additional information is provided in the notes to the financial schedules beginning on page A-9.

DEPARTMENT OF MILITARY AFFAIRS
SCHEDULE OF BUDGETED REVENUE - ESTIMATE AND ACTUAL
FOR THE TWO FISCAL YEARS ENDED JUNE 30, 1994

	Federal Indirect Cost Recoveries[1]	Licenses and Permits	Charges For Services	Grants, Contracts, Donations	Federal	Total
Fiscal Year 1993-94						
GENERAL FUND						
Estimated Revenue	$ 500					$ 500
Actual Revenue	0					0
Collections Over (Under) Estimate	$ (500)					$ (500)
SPECIAL REVENUE FUND						
Estimated Revenue	$13,600	$60,000	$11,000	$12,000	$5,777,664	$5,874,264
Actual Revenue	13,546	70,396	11,080	5,404	5,266,132	5,366,558
Collections Over (Under) Estimate	$ (54)	$10,396	$ 80	$(6,596)	$ (511,532)	$ (507,706)
Fiscal Year 1992-93						
GENERAL FUND						
Estimated Revenue	$ 500					$ 500
Actual Revenue	0					0
Collections Over (Under) Estimate	$ (500)					$ (500)
SPECIAL REVENUE FUND						
Estimated Revenue		$31,500		$10,000	$4,653,565	$4,695,065
Actual Revenue		42,897		1,698	4,384,839	4,429,434
Collections Over (Under) Estimate		$11,397		$(8,302)	$ (268,726)	$ (265,631)

[1] See note 5 on page A-10.

This schedule is prepared from the Statewide Budgeting and Accounting System. Additional information is provided in the notes to the financial schedules beginning on page A-9.

DEPARTMENT OF MILITARY AFFAIRS
SCHEDULE OF BUDGETED PROGRAM EXPENDITURES AND TRANSFERS OUT BY OBJECT AND FUND - BUDGET AND ACTUAL
FOR THE FISCAL YEAR ENDED JUNE 30, 1994

	Operations Support	Army National Guard	Air National Guard	Disaster Coordination Responses[2]	Veterans Affairs	Disaster Fund	Total
PERSONAL SERVICES							
Salaries	$182,210	$ 415,726	$ 838,020	$ 510,341	$382,627	$ 1,878	$2,330,802
Employee Benefits	43,992	121,065	245,760	137,864	112,819	296	661,796
Total	226,202	536,791	1,083,780	648,205	495,446	2,174	2,992,598
OPERATING EXPENSES							
Other Services	69,436	273,275	16,162	21,709	7,963		388,545
Supplies & Materials	7,096	21,396	58,323	15,316	7,099	375	109,605
Communications	2,491	273,565	696	19,681	18,861	25	315,319
Travel	3,987	19,733		63,283	22,150	929	110,082
Rent		30,135	489	133	6,192		36,949
Utilities		699,429	295,099		173		994,701
Repair & Maintenance	1,390	365,091	51,094	3,220	3,334		424,129
Other Expenses	5,699	14,794		5,115	387		25,995
Total	90,099	1,697,418	421,863	128,457	66,159	1,329	2,405,325
EQUIPMENT AND INTANGIBLE ASSETS							
Equipment	1,047	25,563	400	32,644	1,273		60,927
Intangible Assets	288	1,139			119		1,546
Total	1,335	26,702	400	32,644	1,392		62,473
GRANTS							
From State Sources						105,630	105,630
From Federal Sources				652,906			652,906
Total				652,906		105,630	758,536
BENEFITS & CLAIMS							
To Individuals	2,280						2,280
Total	2,280						2,280
TRANSFERS							
Accounting Entity Transfers		140,523					140,523
Total		140,523					140,523
DEBT SERVICE							
Leases					6,164		6,164
Total					6,164		6,164
TOTAL PROGRAM EXPENDITURES	$319,916	$2,401,434	$1,506,043	$1,462,212	$569,161	$109,133	$6,367,899
GENERAL FUND							
Budgeted	$318,606	$ 757,779	$ 145,579	$ 237,118	$535,288	$221,042	$2,215,412
Actual	306,370	752,109	144,638	223,266	526,306	109,133	2,061,822
Unspent Budget Authority	$ 12,236	$ 5,670	$ 941	$ 13,852	$ 8,982	$111,909	$ 153,590
SPECIAL REVENUE FUND							
Budgeted	$ 13,600	$2,133,635	$1,436,271	$1,288,001	$ 48,180		$4,919,687
Actual	13,546	1,649,325	1,361,405	1,238,946	42,855		4,306,077
Unspent Budget Authority	$ 54	$ 484,310	$ 74,866	$ 49,055	$ 5,325		$ 613,610

[2] See note 6 on page A-11.

This schedule is prepared from the Statewide Budgeting and Accounting System. Additional information is provided in the notes to the financial schedules beginning on page A-9.

DEPARTMENT OF MILITARY AFFAIRS
SCHEDULE OF BUDGETED PROGRAM EXPENDITURES AND TRANSFERS OUT BY OBJECT AND FUND - BUDGET AND ACTUAL
FOR THE FISCAL YEAR ENDED JUNE 30, 1993

	Operations Support	Army National Guard	Air National Guard	Disaster Coordination Responses	Emergency Management Development	Local Reimbursement -DES	Veterans Affairs	Disaster Fund	Total
PERSONAL SERVICES									
Salaries	$212,219	$ 378,123	$ 840,187	$323,792	$219,214		$376,619	$ 391	$2,350,545
Employee Benefits	49,289	96,800	235,396	73,964	52,879		97,560	59	605,947
Total	261,508	474,923	1,075,583	397,756	272,093		474,179	450	2,956,492
OPERATING EXPENSES									
Other Services	56,587	217,061	104,791	13,323	26,495		14,712		432,969
Supplies & Materials	6,119	12,940	3,380	3,727	5,122		9,090	101	40,479
Communications	2,977	265,038	618	11,569	7,792		16,114	21	304,129
Travel	2,495	24,646	2,149	33,467	21,483		22,963	843	108,046
Rent		20,764					5,658		26,422
Utilities		659,757	317,704				228		977,689
Repair & Maintenance	1,245	403,126	132,989	2,400	1,330		1,757		542,847
Other Expenses	3,574	12,806	950	1,539	3,540		1,849		24,258
Total	72,997	1,616,138	562,581	66,025	65,762		72,371	965	2,456,839
EQUIPMENT AND INTANGIBLE ASSET									
Equipment	17,882	2,747	3,142		2,027		7,877		33,675
Intangible Assets	93	170			2,093		152		2,508
Total	17,975	2,917	3,142		4,120		8,029		36,183
CAPITAL OUTLAY									
Buildings							25,388		25,388
Other Improvements							3,531		3,531
Total							28,919		28,919
LOCAL ASSISTANCE									
From State Sources								342,548	342,548
Total								342,548	342,548
GRANTS									
From Federal Sources						$704,561			704,561
Total						704,561			704,561
BENEFITS & CLAIMS									
To Individuals	2,280								2,280
Total	2,280								2,280
TOTAL PROGRAM EXPENDITURES	$354,760	$2,093,978	$1,641,306	$463,781	$341,975	$704,561	$583,498	$343,963	$6,527,822
GENERAL FUND									
Budgeted	$356,033	$ 731,295	$ 184,092	$239,994			$516,371	$389,997	$2,417,782
Actual	354,760	715,735	183,978	223,921			516,346	343,963	2,338,703
Unspent Budget Authority	$ 1,273	$ 15,560	$ 114	$ 16,073			$ 25	$ 46,034	$ 79,079
SPECIAL REVENUE FUND									
Budgeted		$1,699,101	$1,518,136	$252,177	$345,709	$723,000	$123,957		$4,662,080
Actual		1,378,243	1,457,328	239,860	341,975	704,561	42,152		4,164,119
Unspent Budget Authority		$ 320,858	$ 60,808	$ 12,317	$ 3,734	$ 18,439	$ 81,805		$ 497,961
CAPITAL PROJECTS FUNDS									
Budgeted							$ 25,000		$ 25,000
Actual							25,000		25,000
Unspent Budget Authority							$ 0		$ 0

This schedule is prepared from the Statewide Budgeting and Accounting System. Additional information is provided in the notes to the financial schedules beginning on page A-9.

Notes to the Financial Schedules

For the Two Fiscal Years Ended June 30, 1994

1. Summary of Significant Accounting Policies

Basis of Accounting

The department uses the modified accrual basis of accounting, as defined by state accounting policy, for its Governmental Funds. In applying the modified accrual basis, the department records:

Revenues when it receives cash or when receipts are measurable and available to pay current period liabilities.

Expenditures for valid obligations when the department incurs the related liability and it is measurable.

Expenditures may include: entire budgeted service contracts even though the department received the services in a subsequent fiscal year; goods ordered with a purchase order before fiscal year-end, but not received as of fiscal year-end; and equipment ordered with a purchase order before fiscal year-end.

State accounting policy also requires the department to record the cost of employees' annual leave and sick leave when used or paid.

Basis of Presentation

The financial schedule format is in accordance with the policy of the Legislative Audit Committee. The financial schedules are prepared from the Statewide Budgeting and Accounting System without adjustment. Accounts are organized in funds according to state law. The department uses the following funds:

Governmental Funds

General Fund - to account for all financial resources except those required to be accounted for in another fund.

Special Revenue Fund - to account for proceeds of specific revenue sources legally restricted to expenditures for specific purposes. Department Special Revenue Funds include Air and Army National Guard, Federal Emergency Management Assistance, and Veterans Cemetery and License Plate Fees.

Capitol Projects Fund - chapter 776, Laws of 1991 appropriated $25,000 from the Long-Range Building Program to the department as Montana's contribution toward the construction of

the National Women in Military Service for America Memorial at Arlington National Cemetery. The department established a Capital Projects fund in fiscal year 1992-93 to account for this activity.

2. Compensated Leave

Employees at the department accumulate both annual and sick leave. Nonexempt employees accumulate compensation leave covered by the Fair Labor Standards Act. The department pays employees for 100 percent of unused annual leave credits, and 25 percent of unused sick leave credits, and 100 percent of unused Fair Labor Standards Act leave credits upon termination. Accumulated unpaid liabilities for annual and sick leave, and compensatory time are not reflected in accompanying financial schedules. The department absorbs expenditures for termination pay in its annual operational costs. At June 30, 1994, the department had a liability of $222,292 for annual leave, $120,838 for sick leave, and $25,715 for Fair Labor Standards Act leave.

3. Pension Plan

Employees are covered by the Montana Public Employees' Retirement System (PERS). The department's contributions to PERS were $154,041 in fiscal year 1992-93 and $188,879 in fiscal year 1993-94.

4. General Fund Balance

The General Fund is a statewide fund. Each agency does not have a separate General Fund since its only authority is to pay obligations from the statewide General Fund within its appropriation limits. Thus, on an agency's schedules, the General Fund beginning and ending fund balance will always be zero.

5. Indirect Costs

State law requires agencies to attempt to recover indirect costs to the largest extent possible. Each year the department establishes a revenue estimate for federal indirect cost recoveries and applies for money from the Federal Emergency Management Agency. In fiscal years 1992-93 and 1993-94, the federal government indicated no money was available. As a result the

revenue estimate appears on the schedule of revenue for each year in the General Fund but no collections were recorded either year.

Fiscal year 1993-94 was the first year the department recorded Special Revenue Fund indirect cost recoveries from the U.S. Department of Defense as budgeted activity.

6. Change in Programs

In fiscal year 1993-94, the Emergency Management Development and Local Reimbursement-DES programs were combined into the Disaster Coordination and Response program.

7. Litigation - Firefighters

In the previous audit report, we disclosed a lawsuit concerning employment benefits and wages of a group of firefighters at the Montana Air National Guard in Great Falls. The liability issue submitted to the district court was decided against the state in January 1992. The trial on the damage aspects of the issues was completed on October 7, 1992. The district court issued a judgment on January 31, 1994, in the total amount of $485,435, plus costs and attorney fees. Costs and attorney fees amount to $35,315 through the district court litigation. That judgment has been appealed to the Montana Supreme Court. Legal counsel for the state believes the Supreme Court will affirm damages, penalties, liquidated damages and fees of at least $260,000.

Agency Response

DEPARTMENT OF MILITARY AFFAIRS

MARC RACICOT, GOVERNOR

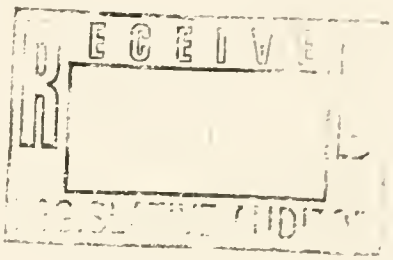
P O BOX 4789

STATE OF MONTANA

OFFICE OF THE ADJUTANT GENERAL
(406) 444-6910

HELENA MONTANA 59604-4789

November 19, 1994



Mr. Scott A. Seacat
Legislative Auditor
Office of the Legislative Auditor
State Capitol
Helena, MT 59620-1705

Dear Mr. Seacat,

Based upon the recent audit by your office on the Department of Military Affairs please find our responses to the audit recommendations. As always, your staff conducted themselves with the professionalism expected of them and offered suggestions we feel are positive and helpful. In return, we hope they left this audit with additional knowledge of the workings of this department.

Recommendation #1
We recommend the department revise procedures to ensure revenue and expenditures are properly recorded in accordance with state law and policy.

Department reply:
We concur. We will address these issues through the revision of procedures and the reallocation of work duties by employees.

Recommendation #2
We recommend the department ensure fixed assets are recorded in accordance with state policy.

Department reply:
We concur. While we feel we have made great strides in this area we will improve our internal procedures which should bring us into full compliance.

Recommendation #3
We recommend the department:
A: Ensure subrecipients have audits completed which comply with federal requirements.

B: Establish a system to monitor subrecipients' compliance with applicable grant requirements.

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Department reply:
We concur.
A: We are in the process of developing a checklist to monitor receipt and review of county audits.

B: The department is currently working with the Legislative Auditors Office and the Local Government Services Bureau of the Department of Commerce to establish a system to monitor subrecipients' compliance with grant requirements per OMB Circular A-128.

Recommendation #4
We recommend the department establish policies and procedures to ensure travel reimbursements comply with state laws and accounting policies.

Department reply:
We concur. We are currently working on travel procedures and disseminating the policies to the personnel responsible for ensuring compliance.

Recommendation #5
We recommend the department make timely payments in accordance with state law.

Department reply:
We concur. The Facilities Management Office (FMO) has committed to a schedule for submission of bills to the Centralized Services Division that will bring the department into compliance. We are in the process of writing the job description of the state employee, in the FMO who will be responsible for timely submission of claims for payment.

Recommendation #6
We recommend the department establish internal controls over collections in accordance with state law and accounting policies.

Department reply:
We concur. The procedure is being established.

Sincerely,

John E. Prendergast
Major General, MTNG
The Adjutant General